

BEFORE THE NEBRASKA TAX EQUALIZATION AND REVIEW COMMISSION

Liberty Holdings, LLC,
Appellant,

v.

Custer County Board of Equalization,
Appellee,

Case Nos: 12C 013 & 13C 012

Decision and Order Reversing Custer
County Board of Equalization

For the Appellant:

Andrew R. Willis,
Cline Williams Wright Johnson &
Oldfather, LLP.

For the Appellee:

Glenn Clark, Deputy County Attorney,
Steve Bowers, Custer County Attorney.

This appeal was heard before Commissioners Thomas D. Freimuth and Nancy J. Salmon.

I. THE SUBJECT PROPERTY

The Subject Property is a commercial parcel located in Broken Bow, Nebraska. The parcel is improved with a 16-unit affordable housing complex. The Property Record Card and legal description of the Subject Property are found at Exhibit 3.

II. PROCEDURAL HISTORY

The Custer County Assessor determined that the assessed value of the Subject Property was \$704,428 for tax year 2012. Liberty Holdings, LLC (herein referred to as the “Taxpayer”) protested this assessment to the Custer County Board of Equalization (herein referred to as the “County Board”) and requested an assessed valuation of \$213,891. The County Board determined that the taxable value for tax year 2012 was \$704,428.¹

The Custer County Assessor determined that the assessed value of the Subject Property was \$704,428 for tax year 2013. The Taxpayer protested this assessment to the County Board and requested an assessed valuation of \$239,623. The County Board determined that the taxable value for tax year 2013 was \$704,428.²

¹ E1.

² E2.

The Taxpayer appealed the decisions of the County Board to the Tax Equalization and Review Commission (herein referred to as the “Commission”). Prior to the hearing, the parties exchanged exhibits and submitted a Pre-Hearing Conference Report, as ordered by the Commission. The Commission held a hearing on October 3, 2013.

III. STANDARD OF REVIEW

The Commission’s review of the determination by a County Board of Equalization is de novo.³ When the Commission considers an appeal of a decision of a County Board of Equalization, a presumption exists that the “board of equalization has faithfully performed its official duties in making an assessment and has acted upon sufficient competent evidence to justify its action.”⁴

That presumption remains until there is competent evidence to the contrary presented, and the presumption disappears when there is competent evidence adduced on appeal to the contrary. From that point forward, the reasonableness of the valuation fixed by the board of equalization becomes one of fact based upon all the evidence presented. The burden of showing such valuation to be unreasonable rests upon the taxpayer on appeal from the action of the board.⁵

The order, decision, determination or action appealed from shall be affirmed unless evidence is adduced establishing that the order, decision, determination, or action was unreasonable or arbitrary.⁶ Proof that the order, decision, determination, or action was unreasonable or arbitrary must be made by clear and convincing evidence.⁷

A Taxpayer must introduce competent evidence of actual value of the subject property in order to successfully claim that the subject property is overvalued.⁸ The County Board need not

³ See, Neb. Rev. Stat. §77-5016(8) (2012 Cum. Supp.), *Brenner v. Banner Cty. Bd. Of Equal.*, 276 Neb. 275, 286, 753 N.W.2d 802, 813 (2008). “When an appeal is conducted as a ‘trial de novo,’ as opposed to a ‘trial de novo on the record,’ it means literally a new hearing and not merely new findings of fact based upon a previous record. A trial de novo is conducted as though the earlier trial had not been held in the first place, and evidence is taken anew as such evidence is available at the time of the trial on appeal.” *Koch v. Cedar Cty. Freeholder Bd.*, 276 Neb. 1009, 1019 (2009).

⁴ *Brenner v. Banner Cty. Bd. Of Equal.*, 276 Neb. 275, 283, 753 N.W.2d 802, 811 (2008) (Citations omitted).

⁵ *Id.*

⁶ Neb. Rev. Stat. §77-5016(8) (2012 Cum. Supp.).

⁷ *Omaha Country Club v. Douglas Cty. Bd. of Equal.*, 11 Neb. App. 171, 645 N.W.2d 821 (2002).

⁸ Cf. *Josten-Wilbert Vault Co. v. Board of Equalization for Buffalo County*, 179 Neb. 415, 138 N.W.2d 641 (1965) (determination of actual value); *Lincoln Tel. and Tel. Co. v. County Bd. Of Equalization of York County*, 209 Neb. 465, 308 N.W.2d 515 (1981)(determination of equalized taxable value).

put on any evidence to support its valuation of the property at issue unless the taxpayer establishes the Board's valuation was unreasonable or arbitrary.⁹

In an appeal, the commission “may determine any question raised in the proceeding upon which an order, decision, determination, or action appealed from is based. The commission may consider all questions necessary to determine taxable value of property as it hears an appeal or cross appeal.”¹⁰ The commission may also “take notice of judicially cognizable facts and in addition may take notice of general, technical, or scientific facts within its specialized knowledge...,” and may “utilize its experience, technical competence, and specialized knowledge in the evaluation of the evidence presented to it.”¹¹

IV. VALUATION

A. Law

Nebraska Statutes section 77-112 provides as follows:

[a]ctual value is the most probable price expressed in terms of money that a property will bring if exposed for sale in the open market, or in an arm’s length transaction, between a willing buyer and a willing seller, both of whom are knowledgeable concerning all the uses to which the real property is adapted and for which the real property is capable of being used. In analyzing the uses and restrictions applicable to real property the analysis shall include a full description of the physical characteristics of the real property and an identification of the property rights valued.¹²

“Actual value may be determined using professionally accepted mass appraisal methods, including, but not limited to, the (1) sales comparison approach using the guidelines in section 77-1371, (2) income approach, and (3) cost approach.”¹³ “Actual value, market value, and fair market value mean exactly the same thing.”¹⁴ Taxable value is the percentage of actual value subject to taxation as directed by section 77-201 of Nebraska Statutes and has the same meaning as assessed value.¹⁵ All real property in Nebraska subject to taxation shall be assessed as of

⁹ *Bottorf v. Clay County Bd. of Equalization*, 7 Neb.App. 162, 580 N.W.2d 561 (1998).

¹⁰ Neb. Rev. Stat. §77-5016(8) (2012 Cum. Supp.).

¹¹ Neb. Rev. Stat. §77-5016(6) (2012 Cum. Supp.).

¹² Neb. Rev. Stat. §77-112 (Reissue 2009).

¹³ *Id.*

¹⁴ *Omaha Country Club v. Douglas County Board of Equalization, et al.*, 11 Neb.App. 171, 180, 645 N.W.2d 821, 829 (2002).

¹⁵ Neb. Rev. Stat. §77-131 (Reissue 2009).

January 1.¹⁶ All taxable real property, with the exception of agricultural land and horticultural land, shall be valued at actual value for purposes of taxation.¹⁷

Nebraska Statutes section 77-1333(1) governs the assessment of affordable housing projects authorized under the Low Income Housing Tax Credit (herein referred to as “LIHTC”) provisions of Internal Revenue Code (“IRC”) § 42.¹⁸ This statute provides that “the county assessor shall perform an income-approach calculation for all rent-restricted housing projects” enabled by IRC section 42.¹⁹ With respect to LIHTC properties, Nebraska Statutes section 77-1333(1) also provides that the “county assessor, in determining the actual value of a specific property, may consider other methods of determining value that are consistent with professionally accepted mass appraisal methods described in section 77-112.”²⁰

The Nebraska Administrative Code contains regulations entitled “Assessment Process for Affordable Housing Projects” promulgated by the Nebraska Department of Revenue’s Property Assessment Division to provide guidance to appraisers and assessors regarding the appraisal of housing “subject to income and/or rent restrictions imposed by the federal Internal Revenue Code (IRC) § 42 Low Income Housing Tax Credits” (herein referred to as the “LIHTC Regulations”).²¹ The LIHTC Regulations confirm that the value to be assessed is the “actual value” as defined in Nebraska Statutes section 77-112 referenced above, but require that the assessor “[recognize] that the actual or market value is influenced by the income and/or rent restrictions (or other restrictions) imposed by the federal/state/local programs (affordable housing).”²² In gathering data for purposes of assessing value, the assessor is encouraged to consider “trends in supply and demand for this type of property” and how the trends are moving in the national, regional, and local economies.²³

The LIHTC Regulations specifically limit the types of “rents” that may be considered for appraisal purposes. The appraiser may consider the following three “rents”: (1) economic rent (i.e., market rent) determined for the county, community, or neighborhood; (2) Maximum Restricted Rent, which is the highest rent that can be charged under Nebraska Investment

¹⁶ See, Neb. Rev. Stat. §77-1301(1) (Reissue 2009).

¹⁷ Neb. Rev. Stat. §77-201(1) (Reissue 2009).

¹⁸ Neb. Rev. Stat. §77-1333(1) (Reissue 2009).

¹⁹ Neb. Rev. Stat. §77-1333(1) (Reissue 2009).

²⁰ Neb. Rev. Stat. §77-1333(1) (Reissue 2009).

²¹ Title 350 Neb. Admin. Code, ch. 51, § 001.01 (2009).

²² Title 350 Neb. Admin. Code, ch. 51, § 001.02 (2009).

²³ Title 350 Neb. Admin. Code, ch. 51, § 004.01 (2009).

Finance Authority (“NIFA”) rules; and (3) actual or contract rent, which is the amount actually paid, and which will never exceed maximum restricted rent.²⁴ The appraiser may also consider the vacancy rates and expenses attributable to the property and whether they are consistent with similar property in the area.²⁵

The LIHTC Regulations provide that the “county assessor shall perform an income-approach calculation for all rent-restricted housing projects constructed” under IRC § 42.²⁶ The Regulations further provide that while the income approach “shall” be performed, the county assessor “may” consider other methods of determining value that are professionally accepted mass appraisal methods under Nebraska Statutes section 77-112.”²⁷

In applying the collected data, the LIHTC Regulations provide that “all factors, including uses and restrictions...**must be taken into account**.”²⁸ The LIHTC Regulations also state that the income approach “may” be the best method for valuation purposes in the absence of sufficient comparable sales.²⁹

The LIHTC Regulations require the county assessor to determine potential gross income of an affordable housing property under the direct capitalization method of the income approach “using the lesser of market rent or the Maximum Restricted Rent.”³⁰ Net operating income (“NOI”) is then determined by adding income from sources other than housing units and subtracting vacancies allowances and allowable expenses.³¹ Finally, the LIHTC Regulations requires capitalization of the NOI by dividing “by a rate which reflects the returns to ownership of the type of property common to the area.”³²

Although the income approach typically utilizes market information to arrive at an assessed value, the LIHTC Regulations provide an exception for “normalized” properties.³³ In the case where a property has “attained a normalized operating history,” the net income of the prior three years may be used to support the net income estimate (applying appropriate reserves).³⁴

²⁴ Title 350 Neb. Admin. Code, ch. 51, § 004.06; See, Title 350 Neb. Admin. Code, ch. 51, § 002.01E -G (2009).

²⁵ Title 350 Neb. Admin. Code, ch. 51, § 004.07 (2009).

²⁶ Title 350 Neb. Admin. Code, ch. 51, § 004.08 (2009).

²⁷ Title 350 Neb. Admin. Code, ch. 51, § 004.08 (2009).

²⁸ Title 350 Neb. Admin. Code, ch. 51, § 005.01 (2009) (emphasis added).

²⁹ Title 350 Neb. Admin. Code, ch. 51, § 005.04A (2009).

³⁰ Title 350 Neb. Admin. Code, ch. 51, § 005.04A, 005.04B and 005.04C(1) (2009).

³¹ Title 350 Neb. Admin. Code, ch. 51, § 005.04A, 005.04B and 005.04C (2009).

³² Title 350 Neb. Admin. Code, ch. 51, § 005.04A (2009).

³³ Title 350 Neb. Admin. Code, ch. 51, § 005.04D (2009).

³⁴ Title 350 Neb. Admin. Code, ch. 51, § 005.04D (2009).

Moreover, the assessor “may” utilize the current year operating budget to “develop a measure” of net operating income for the assessment year.³⁵

The LIHTC Regulations explain that the capitalization rate for income approach purposes represents risk and is applied in calculating the present value of the future expected cash flows from the property.³⁶ The rate is to be derived from the market and considers the impact of tax credits, if any.³⁷ The “band of investment” method may be used or “other generally accepted techniques.”³⁸ Finally, the LIHTC Regulations require the applicable tax levy to be loaded onto the capitalization rate.³⁹

The LIHTC Regulations also permit the appraiser to use the cost method. The LIHTC Regulations caution, however, that the cost method may not be appropriate because the federal/state restrictions on the property create “economic obsolescence,” which is more difficult to ascertain and separate from physical depreciation.⁴⁰

The LIHTC Regulations acknowledge that costs may exceed market value and require consideration of location and the use of affordable housing as rent and/or income restricted.⁴¹ Moreover, “the appraiser should consider whether the value of the property would be affected if it were sold on the open market.”⁴²

B. Summary of the Evidence

The Taxpayer, Liberty Holdings, LLC, purchased the Subject Property from Broken Bow Apartments I Limited Partnership (“Broken Bow Apartments”) for \$93,611.90 on October 20, 2011. The Subject Property, which was constructed in 1997, includes 16 apartments that are categorized as follows: (1) 10 two-bedroom, one-bath units; (2) 2 two-bedroom, two-bath units; and (3) 4 three-bedroom, two-bath units.⁴³

Exhibit 4 discloses that Broken Bow Apartments entered into a Land Use Restriction Agreement (“LURA”) with the Nebraska Investment Finance Authority (“NIFA”) on January 29, 1998. The LURA imposed rent restrictions for a term of 45 years on the Subject Property in

³⁵ Title 350 Neb. Admin. Code, ch. 51, § 005.04D (2009).

³⁶ Title 350 Neb. Admin. Code, ch. 51, § 005.04E(1) (2009).

³⁷ Title 350 Neb. Admin. Code, ch. 51, § 005.04E(2) (2009).

³⁸ Title 350 Neb. Admin. Code, ch. 51, § 005.04E(2) (2009).

³⁹ Title 350 Neb. Admin. Code, ch. 51, § 005.04E(3) (2009).

⁴⁰ Title 350 Neb. Admin. Code, ch. 51, § 005.02C (2009).

⁴¹ Title 350 Neb. Admin. Code, ch. 51, § 005.02C(1) (2009).

⁴² Title 350 Neb. Admin. Code, ch. 51, § 005.02C(1) (2009).

⁴³ See, E3:11-13; E21.

exchange for qualification for tax credits under the Low Income Housing Tax Credit (“LIHTC”) program governed by Section 42 of the Internal Revenue Code of 1986.⁴⁴ Under the terms of the LURA, all of the Subject Property’s apartments are required to “have rents affordable for an income level at or below 52.4% of the applicable area median income.”⁴⁵

The Taxpayer effectuated an “Assumption of Land Use Restriction Agreement for Low Income Housing Tax Credits” as of October 11, 2011, which was filed with the Custer County Register of Deeds on April 6, 2012 (herein referred to as the “LURA Assumption Agreement”).⁴⁶ This LURA Assumption Agreement subjects the Taxpayer to the LURA’s rent restrictions and 45-year term in connection with its ownership and operation of the Subject Property’s apartment units.⁴⁷

Craig Reid testified on behalf of the Taxpayer. Reid is the managing member of PAC Holdings, LLC, which is the Taxpayer’s managing member.⁴⁸

Reid testified that he is a licensed real estate agent, and that he owns and manages 70 total commercial rental properties in nine states, including Nebraska. Of these 70 properties, 45 utilized tax credits for formation purposes similar to the Subject Property.

Reid testified that the LIHTC tax credits that funded the affordable housing project situated on the Subject Property had expired at the time of the Taxpayer’s purchase in 2011.⁴⁹ He stated, however, that the Subject Property was subject to the LURA’s rent restrictions for tax years 2012 and 2013.

Reid testified that on the same day of the Taxpayer’s purchase of the Subject Property in 2011, it also purchased four other Nebraska LIHTC properties in Cheyenne County (Sidney), Adams County (Hastings), Box Butte County (Alliance), and Dawes County (Chadron). Reid further stated that, similar to the status of the Subject Property, the LIHTC tax credits that funded these affordable housing projects had expired prior to the date of purchase in 2011, but the LURA income and rent restrictions remained.

Reid testified that the income and rent restrictions associated with the Adams County property were removed in 2012 after the 2011 purchase.⁵⁰ He further testified that the other

⁴⁴ See, E4.

⁴⁵ E4:4.

⁴⁶ E5.

⁴⁷ See, E5.

⁴⁸ See, E5:3.

⁴⁹ See, E28.2

⁵⁰ See, E22:1.

three properties purchased on the same day as the Subject Property remained subject to the LURA income and rent restrictions as of the date of the hearing before the Commission.

The Taxpayer asserted that the County’s appraiser failed to consider the Subject Property’s income and rent restrictions contained in the above-noted LURA for valuation purposes for tax years 2012 and 2013. The Taxpayer further asserted that market rent in Broken Bow is lower than the LIHTC Maximum Restricted Rent permitted by NIFA and IRC § 42 and should therefore be used for income approach valuation purposes.

In support of the latter assertion, the Taxpayer provided its rent roll for all 16 apartment units, together with historical gross rent data for Broken Bow derived from the year 2000 U.S. Census and the U.S. Census American Community Survey for the periods 2005 – 2009 and 2006 – 2010.⁵¹ For illustration purposes in support of its assertion that market rent rather than LIHTC Maximum Restricted Rent should be used for income approach valuation purposes, the Taxpayer provided the following schedule entitled “Maximum Market Rent” that is “based on market conditions” in Custer County:⁵²

Unit Type	# Units	Rent/Unit	Annual Rent/Unit	Total Annual Rent
2BR, 1BA	10	\$375	\$4,500	\$45,000
2BR, 2BA	2	\$400	\$4,800	\$9,600
3BR	4	\$425	\$5,100	\$20,400 ⁵²
Total	16			\$75,000

The Taxpayer also provided a schedule entitled “Max LIHTC Rent,” which is derived with the use of the “Novogradic LIHTC Rent Calculator” at 52.4% of the Area Median Income (“AMI”).⁵³ That schedule provides that the maximum LIHTC rent net of utility allowance for a two-bedroom apartment is \$615 per month and \$705 per month for a three-bedroom unit, which results in annual rent in the amount of \$122,400.⁵⁴

⁵¹ E21:6 – E21:13 (rent roll); E21:5 (U.S. Census and U.S. Census American Community Survey rent data for Broken Bow).

⁵² E20 & E21. The Taxpayer’s schedule found at E20 provides that the total annual rent for the 3BR property is \$20,480. This is clearly an error and has been corrected in the chart above (4 x \$5,100 = \$20,400).

⁵³ E21. See, E4:4 (the LURA requires all of the Subject Property’s apartments to “have rents affordable for an income level at or below 52.4% of the applicable area median income”).

⁵⁴ E21 [(12 two-bedrooms x \$615 x 12 months) + (4 three-bedrooms x \$705 x 12 months) = \$122,400.]

Reid's opinion of value of the Subject Property was \$264,000 for tax years 2012 and 2013, based on the income approach.⁵⁵ This opinion of value uses the following income approach factors: (1) Potential Gross Income ("PGI"): \$75,000; (2) Vacancy & Credit Loss: 10%; (3) Expense Ratio: 53%; and (4) Capitalization Rate: 10.5%.⁵⁶

The Taxpayer's income approach calculations found at Exhibit 20 and pages one and two of Exhibit 21, together with Reid's testimony, indicate that the capitalization rate is unloaded and therefore does not include real estate taxes. Reid indicated that real estate taxes were included in the expense ratio.

The Taxpayer's capitalization rate is based on the band of investment method.⁵⁷ The 10.5% rate used to derive the \$264,000 opinion of value of tax years 2012 and 2013 is an average of the 10.54% rate derived for tax year 2012 and the 10.46% rate derived for tax year 2013.⁵⁸

Connie Braithwaite, the Custer County Assessor, testified on behalf of the County. She stated that she hired Stanard Appraisal to perform the valuation of the Subject Property for tax years 2012 and 2013.

While Braithwaite's testimony and the Form 422 found at page four of Exhibit 3 indicate that the County Board relied on Stanard Appraisal's \$704,428 cost approach valuation for tax years 2012 and 2013, the Property Record Card's worksheet found at page 14 of Exhibit 3 sets forth the following variables in deriving an income approach valuation in the amount of \$703,257: (1) Annual Rent: \$187,535; (2) Vacancy & Credit Loss: 25%; (3) Expense Ratio: 35%; (4) Capitalization Rate: 11%; (5) Tax Load: 2%; (6) Loaded Capitalization Rate: 13%. Braithwaite stated that these income approach variables were based on the market without consideration of the above-noted LURA's income and rent restrictions. She acknowledged, however, that the Taxpayer provided her with this LURA information as required on an annual basis.

Mark Stanard, a certified general appraiser licensed in Nebraska, testified on behalf of the County. Stanard testified that he valued the Subject Property on a fee simple basis, using a cost approach that derived a valuation in the amount of \$704,428 for tax years 2012 and 2013.⁵⁹

⁵⁵ See, E20 & E21. The 18% vacancy and collection rate originally set forth on Exhibit 20 was changed to 10% with an interlineation during the hearing.

⁵⁶ E20 and E21.

⁵⁷ E26 and E27.

⁵⁸ See, E21:1

⁵⁹ See, E3:13.

The following details of this cost approach are disclosed in the Property Record Card for the Subject Property at page 13 of Exhibit 3: (1) Total Replacement Cost New (“RCN”) - \$1,153,031; (2) Total Physical & Functional Depreciation - (\$491,158); (3) RCN Less Physical & Functional Depreciation – \$661,873; (4) Total RCN Less Depreciation \$661,873; (5) Land Value - \$42,555; 6) Total Cost Value \$704,428 (\$661,873 +\$42,555 = \$704,428). The cost approach detail set forth on the Property Record Card does not adjust for economic depreciation.⁶⁰ Additionally, Stanard stated that the Property Record Card’s line-item for total physical and functional depreciation in the amount of \$491,150 was attributable solely to physical rather than functional depreciation

Stanard testified that this cost approach valuation does not consider economic depreciation or external obsolescence because he valued the Subject Property on a fee simple basis without consideration of the LURA’s income and rent restrictions.⁶¹ He further testified that Nebraska Statutes section 77–1733, which governs the assessment of LIHTC affordable housing projects, involves valuation on a lease fee rather than fee simple basis.

Stanard testified that he performed an income approach valuation in compliance with Nebraska Statutes section 77–1733, but he rejected this method in favor of the cost approach. The details of Stanard’s income approach valuation, some of which may be disclosed in the above-noted Property Record Card worksheet found at page 14 of Exhibit 3, were not fully disclosed in the County’s documentary evidence, and he stated that he could not testify regarding the details thereof. He did state, however, that his income approach valuation was based on market-derived information without considerations of the LURA’s income and rent restrictions attached to the Subject Property. He further stated that his income approach valuation amounted to approximately \$500,000 for tax years 2012 and 2013.

C. Analysis

1. The County Board’s Reliance on Stanard’s Cost Approach

The Taxpayer asserted that the County’s appraiser failed to consider the LURA’s rent and income restrictions for valuation purposes. Therefore, the Taxpayer asserted that the County

⁶⁰ E3:13.

⁶¹ See, E3:13.

Board's determinations of the Subject Property's actual value for tax years 2021 and 2013 were arbitrary or unreasonable.

Nebraska Statutes section 77-1333(1) provides that "the county assessor shall perform an income-approach calculation for all rent-restricted housing projects" under the LIHTC provisions of IRC § 42.⁶² With respect to LIHTC properties, Nebraska Statutes section 77-1333(1) also provides that the "county assessor, in determining the actual value of a specific property, may consider other methods of determining value that are consistent with professionally accepted mass appraisal methods described in section 77-112."⁶³

The County's appraiser relied on the cost approach in arriving at an opinion of the Subject Property's actual value for tax years 2012 and 2013. This approach is allowed under Nebraska Statutes section 77-1333(1) by reference to section 77-112.⁶⁴

While the cost approach is allowed under section 77-1333(1), Nebraska's LIHTC Regulations state as follows regarding this method as it relates to the valuation of an affordable housing project such as the Subject Property:

The cost approach may not, in every case, provide an accurate value of the affordable housing development. This is due, in part, to the state and federally imposed encumbrances on the affordable housing development such as qualifications on tenants, rents, and transfer of the property. This element of obsolescence which is more difficult to ascertain is the economic or locational obsolescence; that is, the negative effect on value that is inherent in the area not directly related to the physical condition or design of the improvements. The appraiser should be aware of the proper methodology to document the depreciation used in applying age/life tables, measuring functional obsolescence, and in determining the economic obsolescence which is generally reflected in the relationship of income levels associated with the property. The estimate of functional and economic obsolescence should be consistent with and supported by the assumptions and adjustments to the income approach to valuation. The appraiser must determine if there is economic obsolescence which relates to all multi-family and/or single family housing in the area and if there is a different economic obsolescence applicable to the affordable housing projects. Analysis should consider whether the economic obsolescence is a result of local supply and demand or whether it is related to the restrictions imposed by the land use restriction agreements which impose additional conditions on affordable housing developments. This estimate should be

⁶² Neb. Rev. Stat. §77-1333(1) (Reissue 2009).

⁶³ Neb. Rev. Stat. §77-1333(1) (Reissue 2009).

⁶⁴ Title 350 Neb. Admin. Code, ch. 51, § 005.02 (2009) (specifically authorizing the use of the cost method).

correlated and supported by the assumptions and indicated value resulting from a proper application of the income approach to valuation.⁶⁵

Nebraska's LIHTC Regulations further state as follows regarding the use of the cost approach:

The location of the affordable housing project, coupled with the restrictions on tenant incomes forces (or mandates) owner rents and may cause a greater disparity between affordable housing development's construction cost and its actual or market value. The fact that the development's cost may exceed market value is inherent in certain programs, particularly the LIHTC program. **The actual use of affordable housing developments as rent and/or income restricted housing must be taken into consideration. These restrictions constitute a form of economic obsolescence.** There are land use restriction agreements on the use of the property that may, in some cases, run for up to 50 years. The appraiser should consider whether the value of the property would be affected if it were sold on the open market.⁶⁶

Similar to Nebraska's LIHTC Regulations, "*Valuation of Market Studies of Affordable Housing*" published by the Appraisal Institute indicates that the income approach is the preferred method for purposes of valuing LIHTC properties.⁶⁷ This Appraisal Institute publication also states that the cost approach is limited in the LIHTC context due to difficulty quantifying depreciation, especially external obsolescence.⁶⁸

The County's appraiser testified that his cost approach valuation of the Subject Property did not consider the LURA's income and rent restrictions that the uncontroverted evidence shows were in effect for tax years 2012 and 2013.⁶⁹ Therefore, in light of the above LIHTC Regulations and Appraisal Institute guidance, together with a review of all of the evidence, the Commission finds that the County Board's reliance on this cost approach valuation for tax years 2012 and 2013 was arbitrary or unreasonable.⁷⁰

⁶⁵ Title 350 Neb. Admin. Code, ch. 51, § 005.02C (2009).

⁶⁶ Title 350 Neb. Admin. Code, ch. 51, § 005.02C(1) (2009) (emphasis added).

⁶⁷ *Valuation of Market Studies of Affordable Housing*, Polton, Richard E., Appraisal Institute (2005) p. 91.

⁶⁸ *Valuation of Market Studies of Affordable Housing*, Polton, Richard E., Appraisal Institute (2005) p. 92.

⁶⁹ See, E3:13 (absence of economic depreciation adjustment in the cost approach computation).

⁷⁰ The Commission notes that page 28 of the 2013 Reports and Opinions of the Property Tax Administrator ("PTA") for Custer County state that "the current market is relatively flat for commercial property." The Commission also notes that page 7 of both the 2012 and 2013 edition of the Reports and Opinions of the PTA for Custer County provide that the PTA determined that "Not Enough Information" ("NEI") existed for purposes of rendering an opinion regarding the level of value for the commercial class. These 2012 and 2013 editions of the PTA's Reports and Opinions ("R&Os") for Custer County, which can be accessed via the Commission's website, indicate that the PTA issued these NEI opinions for each year based on concern regarding assessment practices for the commercial class of property. The following excerpt from page 28 of the 2013 R&Os of the PTA for Custer County summarizes this concern:

2. The County's Income Approach Valuation

As indicated previously, page 14 of Exhibit 3 indicates that the County also derived an income approach valuation in the amount of \$703,257. This valuation assumed that "Annual Economic Rent" amounted to \$187,535 for tax years 2012 and 2013, which the County Assessor testified was based on the market without consideration of the LURA's income and rent restrictions.⁷¹

For purposes of utilizing the income approach to value an affordable housing project such as the Subject Property, the LIHTC Regulations require the use of the lesser of market rent or Maximum Restricted Rent.⁷² The evidence shows that the Maximum Restricted Rent amounted to \$122,400 for tax years 2012 and 2013 net of utility allowances.⁷³ Thus, because the \$187,534 annual rent amount used by the County Assessor substantially exceeds Maximum Restricted Rent, the Commission does not give substantial weight to the County's \$703,257 income valuation.

D. Best Evidence of Value

In the case where it is determined that the County Board's determination is unreasonable or arbitrary, the Commission must review the evidence and adopt the most reasonable estimate of actual value presented.⁷⁴ As the LIHTC Regulations and the above-noted Appraisal Institute publication indicate that the income approach is the preferred method for valuing LIHTC projects like the Subject Property, following is an analysis of the best evidence under this method.

During 2012, the Department conducted both an assessment practice review and a review of sales qualification determinations. The review work was prioritized for Custer County after data in the 2012 Reports & Opinions suggested that assessments within the class may not have been applied uniformly. The assessment practice review revealed that approximately one-third of the sold properties changed significantly more than comparable unsold properties; while there are reasons why this could have occurred there was nothing in the county's documentation to explain why these sold properties had a significantly higher change. In the sales verification review, there appeared to be some trimming of outlier sales ratios without explanation as to why the sale was not an arm's length transaction.

⁷¹ E3:14.

⁷² Title 350 Neb. Admin. Code, ch. 51, § 005.04C(1) (2009).

⁷³ E21.

⁷⁴ See, *Brenner v. Banner Cty. Bd. Of Equal.*, 276 Neb. 275, 283, 753 N.W.2d 802, 811 (2008) (Citations omitted); *Omaha Country Club v. Douglas Cty. Bd. of Equal.*, 11 Neb. App. 171, 645 N.W.2d 821 (2002); *Garvey Elevators, Inc. v. Adams County Bd. of Equalization*, 261 Neb. 130, 621 N.W.2d 518 (2001).

1. Maximum Restricted Rent vs. Market Rent

As discussed above, the LIHTC Regulations require the use of the lesser of market rent or Maximum Restricted Rent.⁷⁵ Maximum Restricted Rent amounted to \$122,400 for tax years 2012 and 2013 according to the Taxpayer's calculations based on the Novogradic LIHTC Rent Calculator.⁷⁶ In contrast, the Taxpayer asserted that market rent amounted to only \$75,000 annually for those years and should be used for income approach purposes.

In support of the latter assertion, the Taxpayer provided its rent roll for all 16 apartment units dated September 3, 2013.⁷⁷ This information, which is submitted to NIFA annually, is consistent with the Taxpayer's income and expense statements for year-end 2011 and 2012 indicating gross rental annual income in the approximate amount of \$67,000.⁷⁸ This rent roll information also indicates that the Taxpayer does not receive government rental subsidies for any of the Subject Property's 16 units.⁷⁹ The evidence supports the Taxpayer's assertion that rents are limited by the market to \$75,000 annually. In this regard, the September 2013 rent roll submitted by the Taxpayer indicates as follows: (1) the actual rent charged for all 16 units situated on the Subject Property is substantially less than the amount entered for each unit in the column entitled "Max Rent Allowed;" (2) the actual rent charged for all 16 units is significantly less than the above-noted \$615 per month (two-bedroom) and \$705 per month (three-bedroom) "Max LIHTC Rent" derived by the Novogradic LIHTC Rent Calculator; and (3) half of the 16 total units were occupied by tenants acquired after the Taxpayer's purchase of the Subject Property in October of 2011, and these tenants paid the same rent through September 2013 as compared to current tenants who acquired occupancy prior to the purchase.⁸⁰

The Commission further notes that IRC § 42 and Nebraska's LIHTC Regulations limit rent to 30% of a tenant's income, thereby imposing an additional restriction on Subject Property revenue.⁸¹ The Taxpayer's rent roll indicates that this requirement is satisfied with respect to all 16 Subject Property units.⁸²

⁷⁵ Title 350 Neb. Admin. Code, ch. 51, § 005.04C(1) (2009).

⁷⁶ E21.

⁷⁷ E21:6 – E21:13 (rent roll).

⁷⁸ See, E8, E9, E18, E19.

⁷⁹ E21:6 – E21:13 (see column entitled "Rental Assist. Payment" - \$0 is entered in this column for all 16 units).

⁸⁰ E21:6 – E21:13.

⁸¹ IRC § 42(g)(2); Title 350 Neb. Admin. Code, ch. 51, § 002.01A(6) (2009) ("Rent for a unit is restricted to a maximum of 30 percent (30%) of the applicable income limit or targeted rent level (less an allowance for utilities)).

⁸² E21:6 – E21:13.

In further support of its assertion that rent should be limited to \$75,000 for income approach purposes, the Taxpayer submitted historical gross rent data for Broken Bow derived from the year 2000 U.S. Census and the U.S. Census American Community Survey for the periods 2005 – 2009 and 2006 – 2010.⁸³ This information provides as follows regarding Broken Bow rental rates: (1) Year 2000 (443 units) - 48.76% were between the range of \$300 to \$499 per month, and 86% of all monthly rents were below \$500 per month; (2) 2005 – 2009 (366 units) - 24.86% were between the range of \$300 to \$499 per month, and 54% of all monthly rents were below \$500 per month; and (3) 2006 – 2010 (402 units) - 35.57% were between the range of \$300 to \$499 per month, and 66% of all monthly rents were below \$500 per month.⁸⁴

Valuation of Market Studies of Affordable Housing, which is published by the Appraisal Institute, discusses limitations on the use of Maximum Restricted Rent for income approach valuation purposes based on market conditions in the LIHTC context, stating that “[t]here are no restrictions on charging less than the maximum allowable rents, however. In fact, in some housing markets, the maximum rents may be higher than the project can sustain, and the rents that the marketplace can support will be far lower.”⁸⁵

The Taxpayer’s evidence indicates that the Broken Bow market limits rent for the LIHTC housing located on the Subject Property. Broken Bow is a small community, and the surrounding area is sparsely populated, so the market for tenants who meet the Subject Property’s LIHTC income restrictions is understandably limited. Additionally, IRC § 42(g)(2) and Nebraska’s LIHTC Regulations impose limitations on Subject Property revenue by restricting rent to 30% of a tenant’s income.

The County Assessor testified, however, that market rent amounted to \$187,535 as indicated on her worksheet found at Exhibit 3, page 14. Additionally, while the Taxpayer’s U.S. Census information concerning rents in Broken Bow is useful, the Taxpayer did not submit any information concerning the rent rates for area apartments that are comparable to the Subject Property’s units -- while Broken Bow is not a large community, it certainly has rental options in addition to the Subject Property. Therefore, the Commission finds that the best evidence of value for rental rate purposes is the \$122,400 annual “Max LIHTC Rent” derived by the Taxpayer with the use of the Novogradic LIHTC Rent Calculator.

⁸³ E21:5 (U.S. Census and U.S. Census American Community Survey rent data for Broken Bow).

⁸⁴ E21.5.

⁸⁵ *Valuation of Market Studies of Affordable Housing*, Polton, Richard E., Appraisal Institute (2005), p. 41.

2. Vacancy & Collection Loss Rate

The LIHTC Regulations require a “normal vacancy/collection allowance” for use in the income approach.⁸⁶ The Taxpayer asserts that the appropriate vacancy allowance is 10%,⁸⁷ while the County’s income worksheet uses 25%.⁸⁸

The Taxpayer’s method for determining its 10% vacancy/collection allowance is not clear. The County Assessor, on the other hand, indicated that the 25% vacancy/collection allowance included on her worksheet is based on the market.

The Taxpayer’s income statement for 2011 found at Exhibit 8 indicates an actual vacancy/collection expense of 6% [(\$3,127 “Vacancy” + \$684 “Write-Offs”)/ \$63,480 “Market Rent” = 6%]. The 2012 income statement found at Exhibit 9 indicates an actual vacancy expense of 5% [(\$1,605 + “Vacancy” + \$1,727 “Write-Offs”)/ \$68,760 “Market Rent” = 5%].

The LIHTC Regulations provide that the county assessor can consider actual expense data in determining value under the income approach.⁸⁹ Therefore, because the Taxpayer’s actual vacancy/collection rates are significantly less than the 10% allowance sought, the Commission finds that the best evidence is 6% for tax year 2012 and 5% for tax year 2013.

3. Miscellaneous Income

The LIHTC Regulations require the addition of miscellaneous income to the sum of rent less vacancy/collection allowance for purposes of determining effective gross income (“EGI”) under the income approach.⁹⁰ The Taxpayer’s income statement for 2011 found at Exhibit 8 indicates that miscellaneous income amounted to \$8,538 (\$2,940 “Garage Rent” + \$5,598 “Total Other Income”). The 2012 income statement found at Exhibit 9 indicates that miscellaneous income amounted to \$8,996 (\$3,014 “Garage Rent” + \$5,982 “Total Other Income”).

⁸⁶ Title 350 Neb. Admin. Code, ch. 51, § 005.04C(2) (2009).

⁸⁷ E20, E21.

⁸⁸ E3:14.

⁸⁹ Title 350 Neb. Admin. Code, ch. 51, § 005.04D (2009) (“the assessor may utilize the current year operating budget to develop a measure of NOI for the assessment year”).

⁹⁰ Title 350 Neb. Admin. Code, ch. 51, § 005.04A (2009).

4. Expense Ratio

The LIHTC Regulations require the use of “[p]rojected annual operating expenses” for purposes of determining net operating income (“NOI”) after EGI has been established.⁹¹ The Taxpayer asserts that the appropriate expense ratio is 53%,⁹² while the County’s income worksheet uses 35%.⁹³

The Taxpayer’s 53% expense ratio is based on an approximate average of the expenses of the four properties purchased on the same day as the Subject Property in other counties.⁹⁴ This ratio is less than the Subject Property’s actual expenses in 2011 (60.69%) and 2012 (59.09%).

The County Assessor, on the other hand, indicated that the 35% expense ratio included on her worksheet is based on the market. As also discussed, the County Assessor’s reference to the “market” by implication does not account for the LURA’s income and rent restrictions or other factors unique to affordable housing as they might pertain to the expense ratio, such as government compliance cost and high-risk tenant issues.

The Commission finds that a 53% expense ratio is the best evidence for purposes of the income approach for tax years 2012 and 2013.

5. Capitalization Rate

The LIHTC Regulations expressly provide that “the capitalization rate to be used with the income approach is a market derived capitalization rate.”⁹⁵ The Regulations further provide that “once a market derived capitalization rate has been determined, the property tax levy applicable to the property should be loaded onto the capitalization rate.”⁹⁶

Based on Reid’s testimony and documentary evidence, the Taxpayer’s 10.5 average capitalization rate used for tax years 2012 and 2013 is based on the band of investment method and is unloaded because it does not include property tax expense.⁹⁷ The inputs used by the

⁹¹ Title 350 Neb. Admin. Code, ch. 51, § 005.04C(3) (2009).

⁹² E20, E21.

⁹³ E3:14.

⁹⁴ E22:1

⁹⁵ Title 350 Neb. Admin. Code, ch. 51, § 005.04E(2) (2009) (the Commission notes that the band of investment technique is permitted under this regulation).

⁹⁶ Title 350 Neb. Admin. Code, ch. 51, § 005.04E(3) (2009); See, § 005.04F & F(1) (providing that only the direct capitalization method with the tax levy loaded onto the capitalization rate may be used).

⁹⁷ See, E20, E21, E23 & E26. See also, Title 350 Neb. Admin. Code, ch. 51, § 005.04E(2) (2009) (Nebraska’s LIHTC Regulations permit the use of the band of investment technique for purposes of the determination of the appropriate capitalization rate under the income approach).

Taxpayer in computing its capitalization rate are derived from Iowa Department of Revenue information and include the yield on the Merrill Lynch Universe and S&P 500.⁹⁸

While it is not clear that the Taxpayer’s band of investment method correctly determined “a market derived capitalization rate” of any relevance to Nebraska real property, the County’s 11% unloaded rate is based on the market.⁹⁹ Thus, because the County’s income worksheet appropriately added a 2% tax rate to its 11% market-based capitalization rate, the Commission finds that the best evidence is the County’s 13% loaded capitalization rate for tax year 2012 and 2013.

6. Best Evidence Income Approach Valuation

In accordance with the above analysis, the Commission finds that the best evidence of value for tax years 2012 and 2013 is derived as follows:

INCOME VALUATION	2012	2013
Potential Gross Income (PGI)	\$122,400	\$122,400
Vacancy & Collection Loss		
2012 (6% of PGI)	-\$7,344	
2013 (5% of PGI)		-\$6,120
Miscellaneous Income	\$8,996	\$8,538
Effective Gross Income (EGI)	\$124,052	\$124,818
Expense Ratio (53% of EGI)	-\$65,748	-\$66,154
NET OPERATING INCOME	\$58,304	\$58,664
Capitalization Rate	11%	11%
Loaded Cap Rate (2% Tax Rate)	13%	13%
VALUE	\$448,495	\$451,265

V. CONCLUSION

The Commission finds that there is competent evidence to rebut the presumption that the County Board faithfully performed its duties and had sufficient competent evidence to make its determinations. The Commission also finds that there is clear and convincing evidence that the County Board’s decisions were arbitrary or unreasonable.

⁹⁸ E26 & E 27.

⁹⁹ See, E3:14.

For all of the reasons set forth above, the decisions of the County Board are vacated and reversed.

VI. ORDER

IT IS ORDERED THAT:

1. The decisions of the Custer County Board of Equalization determining the value of the Subject Property for tax years 2012 and 2013 are vacated and reversed.¹⁰⁰
2. The assessed value of the Subject Property for tax year 2012 is: \$448,495.
3. The assessed value of the Subject Property for tax year 2013 is: \$451,265.
4. This decision and order, if no appeal is timely filed, shall be certified to the Custer County Treasurer and the Custer County Assessor, pursuant to Neb. Rev. Stat. §77-5018 (2012 Cum. Supp.)
5. Any request for relief, by any party, which is not specifically provided for by this decision and order is denied.
6. Each party is to bear its own costs in this proceeding.
7. This decision and order shall only be applicable to tax years 2012 and 2013.
8. This decision and order is effective for purposes of appeal on August 25, 2014.

Signed and Sealed: August 25, 2014.

Thomas D. Freimuth, Commissioner

SEAL

Appeals from any decision of the Commission must satisfy the requirements of Neb. Rev. Stat. §77-5019 (2012 Cum. Supp.) and other provisions of Nebraska Statutes and Court Rules

¹⁰⁰ Assessed value, as determined by the County Board, was based upon the evidence at the time of the Protest proceeding. At the appeal hearing before the Commission, both parties were permitted to submit evidence that may not have been considered by the County Board of Equalization at the protest proceeding.

Nancy J. Salmon concurring,

I, concur with the majority that the County Board's determination was unreasonable or arbitrary because it relied upon the County Assessor's cost approach that was not calculated according to applicable rules and regulations established by the Nebraska Department of Revenue.

I concur on the final opinion of value stated by the majority, and income factors included in the majority; however, I arrived at my opinion of the appropriate rental rates used to calculate the potential gross income (PGI) through separate reasoning.

The Taxpayer generally asserted that the actual rent rates associated with the Subject Property are equal to the market rents commanded at non-rent-restricted properties in the Subject Property's market. The actual rents for the Subject Property are significantly less than the maximum restricted rents and result in a PGI of \$75,000.¹⁰¹

The County Assessor asserted that the income approach that they produced relied upon market rents. The County Assessor's income approach had a calculated PGI of \$187,535.20.¹⁰² This PGI exceeds a PGI calculated when using the maximum restricted rents permitted for the Subject Property.¹⁰³

The Taxpayer's computation of the maximum restricted rents is consistent throughout the evidence, and is the only computation of the maximum restricted rents in evidence. The Taxpayer's recertification documents indicate a "max rent allowed" of \$938 for three bedroom units and \$811 for two bedroom units. An examination of the documents indicates that this number indicates the rents affordable at 60% AMI as required for rent-restricted properties, or in other words it certifies that no tenant of the designated rent-restricted units is occupied by tenants which are pay rent in excess of the federally established rental rate affordable at 60% AMI.¹⁰⁴ An examination of the land use restriction agreement (LURA) for the Subject Property indicates

¹⁰¹ See, E21:1.

¹⁰² E3:14.

¹⁰³ \$615 (maximum restricted rent for two bedrooms units) x 12 (two bedroom units) = \$7,380 x 12 (months) = \$88,560. \$705 (maximum restricted rent for three bedrooms units) x 4 (three bedroom units) = \$2,820 x 12 (months) = \$33,840. = \$122,400 PGI. See, E21:1.

¹⁰⁴ See, E21:2-13.

that the target level for the Subject Property is 52.4%.¹⁰⁵ The maximum restricted rents indicated in Exhibit 21, page 1, are purported to represent the rents affordable at 52.4% AMI. These maximum rent calculations are supported by the “max rent allowed” or rents affordable at 60% AMI as recorded in the record certification documents.¹⁰⁶

Given the forgoing, I determine that the County Assessor’s PGI indicates the PGI for the Subject Property calculated using market rents. The PGI calculated using the maximum restricted rents is less than the County Assessor’s PGI. Nebraska Department of Revenue rules and regulations require that the lesser of market rents or maximum restricted rent be used to calculate an income approach for rent-restricted properties.¹⁰⁷

Based on this reasoning, I find that the maximum restricted rents as contained in Exhibit 21, page 1 should be used to calculate the actual value of the Subject Property using the income approach.

I concur with the majority opinion’s reasoning for all other income approach factors.

Nancy J. Salmon, Commissioner

¹⁰⁵ See, E4.

¹⁰⁶ i.e. \$938 is 60% of \$1,563.33 and \$819 is 52.4% of \$1,563.33.

¹⁰⁷ Title 350 Neb. Admin. Code, ch. 51, § 005.04A, 005.04B and 005.04C(1) (06/09).